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ILLINOIS COMMERCE COMMISSION

DOCKET NO. 05-0743

REBUTTAL EXHIBITS SPONSORED BY SCOTT GLAESER

DECEMBER 12, 2006

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REBUTTAL TESTIMONY OF SCOTT A. GLAESER

DECEMBER 12, 2006

I. INTRODUCTION AND WITNESS QUALIFICATIONS

1
2 Q. Please state your name, business address and present position.

3 A. My name is Scott A. Glaeser; my business address is One Ameren Plaza, 1901 Chouteau
4 Avenue, St. Louis, Missouri, 63103. I am currently Vice President, Gas Supply and System
5 Control for Ameren Energy Fuels and Services Company, a wholly owned subsidiary of the
6 Ameren Corporation ("Ameren").

7 Q. Please summarize your educational and employment background.

8 A. I received a Bachelor of Science Degree in Mechanical Engineering from the University of
9 Missouri at Rolla in December of 1986. From 1987 to January 1991 I was a Combustion
10 Engineer for the Granite City Steel Division of National Steel Corporation (now U.S. Steel
11 Corporation). In February of 1991, I accepted the position of Fuel Buyer for Union Electric
12 Company ("UE") in which I was responsible for the purchase of natural gas for the
13 company's gas distribution systems and gas-fired generation. In 1994 I was named
14 Engineer, Gas Supply and Planning, with continuing responsibilities for obtaining reliable and
15 economical gas supply, transportation and storage services for UE's gas distribution
16 systems and gas-fired generation. During 1997 and 1998, in addition to my duties related to

17 the natural gas business, I also acted as a short-term power trader for UE. In March of
18 1998, after the merger of the parent company of Central Illinois Public Service Company
19 with UE, which formed Ameren, I was promoted to the position of Supervising Engineer of
20 Gas Supply and Transportation in Ameren Services Company. In July of that year I was
21 promoted to Manager of the Gas Supply and Transportation Department. In November of
22 2000 I was directly involved with the formation of Ameren Energy Fuels and Services
23 Company ("AFS") by the consolidation of the Gas Supply and Transportation Department
24 and the Fossil Fuels Department. AFS is charged with managing natural gas and generation
25 fuel resources for all Ameren affiliated companies including Ameren's gas distribution utilities
26 and power generation companies. In this position, I continued with management
27 responsibilities over business activities including gas supply acquisition, price hedging,
28 transportation and storage capacity acquisition, system operations, and regulatory affairs for
29 AmerenUE, AmerenCIPS, AmerenCILCO, and AmerenEnergy Generating Company. In
30 October 2004 my function became responsible for the same activities for the Illinois Power
31 Company ("Illinois Power", "IP" or "AmerenIP") gas distribution operations.

32 In October of 2004, I was promoted to my current position of Vice President, Gas
33 Supply and System Control for Ameren Energy Fuels and Services Company. My current
34 responsibilities include all duties included in my previous position plus the management and
35 oversight of the Gas Control function and the End-User Transportation function located in
36 Springfield, Illinois.

37 Q. Have you previously testified before the Commission?

38 A. Yes. I have testified either in person or through the submission of written prepared
39 testimony before this Commission several times, most recently in ICC Docket No. 03-
40 0699, ICC Docket No. 04-0677 and ICC Docket No. 04-0294, which are AmerenIP's
41 2003 and 2004 PGA reconciliation proceeding and the proceeding approving the
42 acquisition of IP by Ameren, respectively.

43 **II. PURPOSE AND SCOPE**

44 Q. What is the subject of your testimony in this case?

45 A. My rebuttal testimony is focused on Staff witness Mr. Eric Lounsberry's proposed
46 disallowance. Specifically, my rebuttal testimony will (1) discuss the Commission's
47 standard of prudence and the application of that standard by Mr. Lounsberry in this case,
48 (2) explain Ameren's due diligence process prior to its acquisition of Illinois Power,
49 specifically with respect to IP's gas storage fields; (3) explain Ameren's reasons for
50 negotiating indemnification provisions with respect to certain gas-related matters in the
51 Stock Purchase Agreement with Dynegy Inc. for the acquisition of IP; and (4) respond to
52 Mr. Lounsberry's citation of certain testimony from ICC Docket No. 04-0294 regarding
53 staffing levels at IP's gas storage fields. Other AmerenIP witnesses - Messrs. Shipp, Hood,
54 Kemppainen and Hower - provide detailed testimony responding to the specific issues
55 raised by Mr. Lounsberry in his direct testimony.

56 **III. STANDARD OF PRUDENCE**

57 Q. What is your understanding of the Commission's standard of prudence?

58 A. It is my understanding that the Commission has adopted the following standard of prudence:

59 Prudence is that standard of care which a reasonable person would
60 be expected to exercise under the same circumstances encountered by
61 utility management at the time decisions had to be made. In determining
62 whether a judgment was prudently made, only those facts available at the
63 time judgment was exercised can be considered. Hindsight review is
64 impermissible.

65
66 Imprudence cannot be sustained by substituting one's judgment for
67 that of another. The prudence standard recognizes that reasonable persons
68 can have honest differences of opinion without the one or the other
69 necessarily being "imprudent." (Illinois Commerce Commission v.
70 Commonwealth Edison Co., ICC Docket 84-0395 (Order issued Oct. 7,
71 1987), p. 17.)

72
73 It is also my understanding that the Commission as well as the Illinois courts have
74 recognized that human errors are unavoidable and that the commission of some errors in an
75 activity does not necessarily mean that a utility was imprudent (e.g., Order in ICC Docket
76 84-0395, p. 19).

77 Q. Do you believe that Mr. Lounsberry is properly applying the prudence standard in
78 recommending his proposed disallowances in this case?

79 A. No, I do not. I believe Staff witness Lounsberry's opinion that IP was imprudent in the
80 actions it took to investigate the decline in deliverability of its Hillsboro Storage Field
81 ("Hillsboro" or "HSF") are based on hindsight and do not adequately take into account the
82 circumstances faced by IP at the time the decisions and actions at issue were being made.
83 His recommendations are based on an after-the-fact analysis of what he thinks IP should

84 have done or should have known based on certain information (to the exclusion of other
85 information that IP had to take into account) at particular points in time. Mr. Lounsberry
86 also greatly oversimplifies the difficulties associated with evaluating the multiple potential
87 causes of the Hillsboro deliverability problems and eliminating potential causes to arrive at
88 the actual cause or combination of causes. His analysis fails to adequately take into account
89 that underground storage reservoirs such as Hillsboro are complex geological systems
90 whose characteristics cannot be known with complete certainty. AmerenIP witnesses
91 Hood, Kemppainen and Hower address these topics in detail in the context of the
92 Hillsboro-specific issues.

93 Q. Do you have any other concerns about Mr. Lounsberry's application of the prudence
94 standard?

95 A. Yes. I believe that Mr. Lounsberry's recommended imprudence disallowances in
96 AmerenIP's 2003 PGA reconciliation case, ICC Docket 03-0699, AmerenIP's 2004 PGA
97 reconciliation, ICC Docket 04-0677, and this case, all of which are based on the same
98 underlying contentions, introduce a level of risk to the gas distribution business that is
99 inconsistent with the level of reward that AmerenIP has the opportunity to earn from this
100 regulated business. While I acknowledge that the proposed disallowance for the 2005
101 reconciliation year (as revised in Mr. Shipp's rebuttal testimony) is not that significant in the
102 absolute, the aggregate amount of the proposed disallowances regarding the Hillsboro issue
103 for the three years is significant. In the aggregate for 2003 through 2005, IP had total

104 purchased gas costs of approximately \$1,098,000,000, which is equal to about 75% of
105 IP's total gas utility operating revenues for the three-year period. Illinois Power earns no
106 return on the sale of this gas to customers and earns no return for acquiring this gas for its
107 customers. IP's return on its gas utility business is earned only from the allowed rate of
108 return applied to its assets included in rate base. In 2003 through 2005, Illinois Power had
109 aggregate net gas utility income of approximately \$81.3 million, which represented only
110 about a 5.5% margin on its gas operating revenues. Mr. Lounsberry's proposed
111 imprudence disallowances of more than \$10.5 million for the three years represent about
112 13% of IP's total gas operating income for the three-year period. Thus, Mr. Lounsberry's
113 proposed disallowances impose a very substantial risk of loss on IP's relatively modest
114 rewards from the gas utility business. I note in contrast to this severe impact on Illinois
115 Power that the \$10.5 million of gas costs that Mr. Lounsberry has recommended be
116 disallowed in the three cases relating to the Hillsboro issue represented only about 1% of
117 the total purchased gas costs billed to customers in the three years 2003-2005.

118 From a policy perspective I believe the Commission should have grave concerns
119 about the message being sent to gas utilities in Illinois by Mr. Lounsberry's proposed
120 disallowance. I believe that other utilities that operate gas storage facilities would look at
121 the testimony of Messrs. Hower, Shipp, Kempainen and Hood, compare it to Mr.
122 Lounsberry's testimony and conclude that Ameren prudently managed the Hillsboro
123 Storage Field but yet was still subjected to a disallowance. Then they would logically look

124 at their own operations and question the risk they have in the continued operations of their
125 storage facilities. They would also have to factor in this additional risk if they were
126 contemplating the further expansion or initial development of additional storage capacity.

127 During a period of record high gas prices, extreme price volatility, and potential gas
128 shortages, the expansion of storage capacity should be strongly supported and encouraged
129 by the industry and regulatory agencies. Storage is a primary factor affecting gas prices (as
130 evidenced, for example, by the effects on NYMEX futures prices when the Energy
131 Information Administration weekly storage inventory report is released) and is an important
132 tool for gas utilities to employ in order to dampen price volatility, reduce the risk of supply
133 shortages during the critical winter operating season, and to replace interstate pipeline
134 capacity which is becoming very constrained. At the national level, the development of
135 storage capacity is strongly encouraged as one of several key solutions to the crisis the gas
136 industry is facing in this country. For example, Congress in Section 312 of the Energy
137 Policy Act of 2005 has authorized FERC to authorize natural gas companies to provide
138 natural gas storage and storage-related services from new storage facilities at market-based
139 rates, even where the company cannot demonstrate that it lacks market power, if FERC
140 determines that market-based rates are in the public interest and necessary to encourage the
141 construction of gas storage capacity in an area needing storage services. It is clear
142 that storage should be expanded in the U.S. to help mitigate price volatility and price spikes
143 the country has endured since the winter of 2000/2001. At a time when storage capacity

144 should be expanded and enhanced for the ultimate benefit of customers, imposition of a
145 disallowance as recommended by Mr. Lounsberry based upon the evidence in this case
146 would create an atmosphere of uncertainty and additional risk which I believe would
147 discourage further development of gas storage facilities in Illinois.

148 Q. At lines 98-133 and 278-286 of his direct testimony, Mr. Lounsberry discusses ICC
149 Docket No. 03-0699 and points out that in that docket he made virtually the same
150 arguments concerning the Hillsboro Storage Field issues and the Commission agreed with
151 his position and found Illinois Power acted imprudently. What is AmerenIP's response?

152 A. AmerenIP respectfully disagrees with the Commission's findings and conclusions in its
153 Order in Docket No. 03-0699 to the extent the Commission adopted Mr. Lounsberry's
154 arguments and found IP acted imprudently with respect to Hillsboro. AmerenIP has
155 initiated the process to appeal the Commission's Order in ICC Docket No. 03-0699 to the
156 Illinois Appellate Court.

157 **IV. AMEREN'S PRE-ACQUISITION DUE DILIGENCE**

158 Q. Beginning at the top of page 52 of his direct testimony, Mr. Lounsberry quotes from a "due
159 diligence" report prepared by Ameren in connection with its investigation of whether to
160 acquire Illinois Power. Are you aware of the report he cites?

161 A. Yes, I am. I was part of the Ameren acquisition team that was responsible for performing
162 due diligence during Ameren's investigation and negotiations concerning the possible
163 purchase of Illinois Power from Dynegy. In fact, I was the co-author of the specific

document Mr. Lounsberry quotes, “Due Diligence Analysis of Illinois Power’s Gas Supply and System Operations”.

Q. Mr. Lounsberry states it is his opinion that Ameren’s own due diligence report verifies his conclusion that “IP is unwilling to spend capital on its storage activities” (Staff Exhibit 2.00, page 52). Do you agree with his assessment?

A. No, I do not, for several reasons. First, the due diligence process is a difficult process with several purposes from the potential buyer’s perspective. A primary purpose is to identify and quantify as many negatives and concerns as possible about the company or assets under consideration for purchase, as a basis for negotiating the acquisition price or to terminate the acquisition. In addition, all possible risk exposures must be identified and analyzed with limited time and incomplete information in order to determine the maximum possible risk scenario, even if the risks turn out later to be minor or nonexistent. Of course the selling party wants just the opposite and in an attempt to “protect” its positions seeks to limit the potential purchaser’s due diligence process by limiting the scope of the investigation and access to its assets, records, and personnel. In the same paragraph from the due diligence report in which Mr. Lounsberry extracted the sentence addressing IP’s capital expenditures on storage was another sentence that described the short and restricted nature of the due diligence process with Dynegy. The additional sentence reads: **BEGIN**

CONFIDENTIAL

184 **END CONFIDENTIAL** This statement makes clear that the limited

185 amount of information, time, and access to key personnel available to Ameren’s acquisition
186 team by Dynegy resulted in an imperfect understanding of the operating risks and capital
187 expenditures associated with the Hillsboro Storage Field and Illinois Power’s other storage
188 fields. The end result is that “due diligence” conclusions are based on incomplete or
189 imperfect information, but they are made with the objective of providing a basis for
190 negotiating a favorable purchase price. The statement from the due diligence report quoted
191 by Mr. Lounsberry must be considered with that context in mind.

192 Q. Post close, what is your current opinion of IP’s historic capital spending practices at its
193 storage facilities?

194 A. Detailed integration of Illinois Power into Ameren began immediately after the September
195 30, 2004 close of the acquisition. At this time, Ameren management began to have full
196 access to Illinois Power’s assets, personnel, and records. The detailed integration activities
197 uncovered no evidence that IP’s capital spending at its gas storage fields has been
198 inadequate. In fact, examining the total expenditures for the storage fields, which includes
199 capital and O&M expenses, reveals relatively stable total expenditures with some variations
200 due to larger capital projects in certain years (replacement of major equipment such as
201 generators or reboilers). These expenditure variations are to be expected when managing
202 complex physical assets with large mechanical components which are replaced from time to
203 time but not every year. There was no evidence of needed capital projects that were

204 rejected or deferred due to capital spending constraints and no evidence that capital
205 projects were not implemented in a timely manner.

206 **V. DYNEGY INDEMNIFICATION IN STOCK**
207 **PURCHASE AGREEMENT**

208 Q. Beginning at line 1432 (page 68) of his direct testimony, Mr. Lounsberry introduces some
209 additional evidence that he deems “pertinent” to this case, specifically, the existence of an
210 indemnification clause in the Stock Purchase Agreement between Ameren and Dynegy for
211 the acquisition of IP. Mr. Lounsberry states that Ameren included this provision in the
212 Stock Purchase Agreement because it “was so concerned about the manner in which IP
213 and Dynegy had operated the field”. Is his assessment accurate?

214 A. No, it is not. First, the inclusion of an indemnification provision in an acquisition agreement
215 is the product in part of the uncertainties inherent in the due diligence process, as I have
216 described, as well as the uncertainties inherent in the outcome of litigation that is pending or
217 may result from events prior to the acquisition date. Indemnification provisions in
218 acquisition agreements are commonly used as a way for the parties to share or allocate the
219 risks associated with such uncertainties. There are of course other methods that can be
220 used to share or allocate such uncertainties including adjusting the purchase price, providing
221 for additional working capital adjustments, or giving up indemnification rights in return for
222 other unrelated consideration. Of course, the resulting final acquisition agreement is the
223 product of extensive, arms’-length negotiations. In this case, the parties negotiated to have

an indemnification provision covering specific litigation and regulatory matters as opposed to one of the alternative approaches.

I note that Mr. Lounsberry has quoted only a small portion of the indemnification provision in the Stock Purchase Agreement. The indemnification section of the Stock Purchase Agreement is more than seven pages long, not including attachments. Additionally, one of the schedules referenced in the indemnification section lists over 40 pages of potential litigation exposure. These indemnifications of potential risk exposures cover all aspects of IP's utility business including environmental issues, tax issues, outstanding lawsuits, and warranties and representations by Seller. Mr. Lounsberry's attempt to isolate one indemnification clause from this extensive list of indemnifications as evidence of imprudence on the part of IP is misleading and misrepresents the purpose of indemnification clauses.

Q. Why were the open PGA cases and the Hillsboro Storage Field inventory issue specifically identified in the indemnification provision in the Stock Purchase Agreement?

A. With respect to the open PGA cases, Ameren did not think it should bear 100% of the risk of possible disallowances in the open reconciliation proceedings relating to reconciliation periods prior to the closing of the acquisition while IP was under the control of Dynegy. With respect to the provisions relating to Hillsboro Storage Field, at the time we were negotiating to acquire IP (late 2003-early 2004), Illinois Power had recognized that an inventory adjustment was necessary at Hillsboro and that some portion of the base gas had probably been withdrawn and supplied to customers, but IP had not finally determined the

244 actual amounts or the plan for recovery. Our concerns focused on the risks associated with
245 obtaining cost recovery in future periods for the consequences of past events while IP was
246 under the control of Dynegy or other previous ownership.

247 Finally, I would place a different construction on the indemnification provision than
248 does Mr. Lounsberry. Specifically, Ameren was sufficiently unconcerned about risks
249 associated with the open PGA cases and the Hillsboro Storage Field issues that it was
250 willing to agree to a 50-50 sharing of those risks with Dynegy rather than insisting that
251 Dynegy bear 100% of the risks.

252 **VI. TESTIMONY CITED BY MR. LOUNSBERRY FROM**
253 **ICC DOCKET NO. 04-0294**

254 Q. At lines 1056 to 1068 of his direct testimony, Mr. Lounsberry refers to certain testimony of
255 an Ameren witness in the proceeding for approval of Ameren's acquisition of IP (ICC
256 Docket No. 04-0294) and comes to the conclusion that it indicates "Ameren shared some
257 of Staff's concerns regarding the level of oversight that IP had over its storage operations".

258 Do you agree with the conclusion Mr. Lounsberry draws from the testimony he cites from
259 ICC Docket No. 04-0294?

260 A. No. Mr. Lounsberry is referring to the rebuttal testimony of Ameren witness Jimmy L.
261 Davis filed on July 20, 2004, in ICC Docket No. 04-0294. I was an integral part of the
262 review team at Ameren which was tasked with making recommendations to Ameren's
263 executive management concerning the acquisition of IP's gas storage fields, and in fact I
264 participated in the development of Mr. Davis' testimony in ICC Docket No. 04-0294.

265 Here is the actual testimony of Mr. Davis to which Mr. Lounsberry is referring:

266 Ameren is familiar with the concerns raised by Staff in the IP 2001
267 PGA reconciliation (ICC Docket 01-0701) and also identified in Mr.
268 Lounsberry's testimony which discusses the staffing levels at the IP storage
269 fields. If the Commission approves Ameren's acquisition of IP, Ameren will
270 control 12 storage fields with a combined storage plant in service of
271 approximately \$140 million. Ameren recognizes that these storage assets
272 are critical to the continued ability of Ameren to provide safe, reliable, and
273 economic gas service to our customers and takes the management of these
274 assets seriously. Upon closing of the transaction, Ameren will establish a
275 manager level position to lead its storage organization. In addition to a
276 manager position, Ameren expects, within six months of closing, to add
277 engineering and supervisory personnel who will focus on storage activities
278 and responsibilities. These positions will be in addition to the existing
279 storage personnel at Central Illinois Public Service Company d/b/a
280 AmerenCIPS, Central Illinois Light Company d/b/a AmerenCILCO, and
281 IP.

282
283 As you can see, while Mr. Davis indicated that Ameren was familiar with the concerns Mr.
284 Lounsberry had identified in prior testimony, Mr. Davis did not state that Ameren "shared"
285 or agreed with Mr. Lounsberry's concerns relating to the staffing of IP's storage facilities.
286 In addition, while (as Mr. Lounsberry as well as Mr. Shipp describe), IP's staffing of its
287 storage fields during the period focused on by Mr. Lounsberry in this case, 1999 through
288 2001, was based on a manpower plan developed and adopted by IP in 1995, Ameren's
289 post-acquisition plans described in Mr. Davis' testimony were based on Ameren's
290 evaluation of the staffing of IP's storage facilities in 2004 and of the management and
291 staffing needs for the entire Ameren storage field operation when IP's storage operations
292 were integrated with those of the existing Ameren companies. It was not based on an
293 evaluation of the appropriateness of IP's gas storage staffing and organization in earlier

294 years. The most important factor in Ameren's evaluation was the need to reorganize all of
295 its gas storage field operations post-acquisition (including the AmerenCIPS and
296 AmerenCILCO fields as well as the AmerenIP fields) into an organization consistent with
297 the overall Ameren management structure and in recognition of the growth of the storage
298 field operations from 5 storage facilities to 12 storage facilities after the acquisition and
299 integration of IP.

300 Q. Are there policy reasons why the Commission should give the testimony cited by Mr.
301 Lounsberry from ICC Docket No. 04-0294 no weight in this reconciliation proceeding?

302 A. Yes. In ICC Docket No. 04-0294, Ameren stated that it would evaluate and potentially
303 make changes in the areas identified by Mr. Lounsberry. This was done in an effort to
304 cooperate with Staff as well as to expedite approval and closing of the acquisition of IP, and
305 with the knowledge that the Commission could impose conditions on its approval of
306 Ameren's acquisition of IP. Now, we find Ameren's positive response to Staff and its
307 commitment to action in ICC Docket No. 04-0294 being cited by Staff against Ameren as
308 evidence of imprudence in a prior period. If the Commission were to use Ameren's
309 testimony cited by Mr. Lounsberry from ICC Docket No. 04-0294 as evidence of
310 imprudence in this case, then in the future utilities could be reluctant to take actions in
311 response to Staff recommendations concerning management, staffing and operations, for
312 fear that Staff would then cite the utility's positive actions against it as evidence that the
313 previous management, staffing or operational structure or practice involved was imprudent.

314 Q. Referencing the same portion of Mr. Lounsberry's rebuttal testimony (lines 1056-1068),
315 Mr. Lounsberry states that the Ameren testimony in ICC Docket No. 04-0294 notes that
316 Ameren was adding a manager position to lead its storage operations as well as additional
317 engineering and supervisory personnel who would focus on storage activities and
318 responsibilities. Subsequent to closing the acquisition of IP, what staffing additions if any has
319 Ameren made to the storage operations?

320 A.. Mr. Davis testified in Docket No. 04-0294 that Ameren would be adding a manager
321 position to oversee all the storage fields of IP, AmerenCIPS and AmerenCILCO, and
322 Ameren has done so. However, Ameren has added this manager position because of the
323 greatly expanded scope of Ameren's storage field operations due to the acquisition of IP,
324 not because of any perceived insufficiency of staffing within the IP storage field operations.
325 The acquisition of IP more than doubled the number of Ameren's gas storage fields in
326 Illinois from five to twelve. Because of the substantial increase in gas storage assets to be
327 owned and operated by Ameren following the acquisition of IP, it was appropriate to create
328 a manager-level position over all the Ameren-owned storage fields in Illinois, whereas such
329 a position was not viewed as necessary when Ameren owned and operated only five
330 storage fields in Illinois. For the same reason, Ameren has determined that it would be
331 appropriate to add one other engineering and supervisory level position to oversee
332 Ameren's vastly expanded number of storage fields and storage field assets in Illinois. This
333 addition also was not motivated by any perceived deficiencies in terms of the size of the

334 staffing within the IP storage field organization, but rather by recognition that within the
335 overall Ameren management structure the number of storage fields and amount of storage
336 field assets under management would now be significantly expanded. Further, with the
337 expanded amount of storage fields and storage assets under Ameren ownership and the
338 resulting economies of scale, management and supervisory staffing levels could be justified
339 and warranted that could not be supported when Ameren owned only five gas storage fields
340 in Illinois.

341 Q. What is Ameren's current view with respect to the levels of staffing required at the
342 AmerenIP storage fields?

343 A. Ameren has not found it necessary to add either additional supervisors or additional
344 operating personnel at the AmerenIP storage fields. Therefore, Ameren has not seen a
345 need to depart from the pre-acquisition IP staffing model at the AmerenIP storage fields. In
346 fact, Ameren is utilizing certain aspects of the IP staffing model, such as concepts of the self-
347 directed work team model discussed in Mr. Shipp's rebuttal testimony, at Ameren's other
348 storage fields.

349 Q. Does this conclude your prepared rebuttal testimony?

350 A. Yes, it does.